

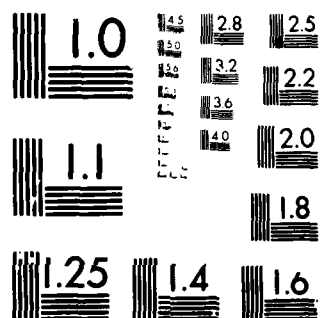
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SUMMARY OF DISCUSSION--WORKSHOP ON COMPENSATION AGREEMENTS IN U--ETC(U)
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**SUMMARY OF DISCUSSION—WORKSHOP ON COMPENSATION
AGREEMENTS IN U.S.—USSR ECONOMIC RELATIONS**

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Paper prepared by staff of SRI International for a parallel
research program with the Institute of World Economy and
International Relations of the Academy of Sciences of the
USSR.

October 1978

Final Report

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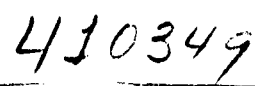
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Allen / Lenz

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PREFACE

This report represents a summary of the discussion at the SRI/IMEMO Workshop on Compensation Arrangements held in Moscow, 6-11 December 1977. This workshop was one facet of a continuing parallel research program on U.S.-USSR economic relations developed by SRI International and the Institute for the World Economy and International Relations of the Soviet Academy of Sciences. A list of participants and observers appears as Appendix A.

Those contributing to the preparation of the summary included M. Mark Earle, Jr., Gary Fromm, Charles Movit and Francis W. Rushing. Valuable assistance was provided by Allen Lenz and Scott Bozek of the Department of Commerce's Bureau of East-West Trade.

ACKNOWLEDGMENT

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I INTRODUCTION

On 7-9 December 1977 working groups from SRI International and the Institute for the World Economy and International Relations (IMEMO) of the Soviet Academy of Sciences took part in a workshop addressing the development of US-USSR economic relations via compensation agreements. The research exchange was part of a program of parallel research between the two institutes under the auspices of the Binational Commission on Collaboration and Cooperation in the Humanities and Social Sciences of the American Council of Learned Societies and the Soviet Academy of Sciences. The workshop had been preceded by an exchange of draft reports by the institutes on problems and prospects for economic relations on a compensatory basis between the US and the Soviet Union. The working groups included scholars from other research institutes in the US and USSR and participation was invited by government observers from both countries.

II MAIN DISCUSSION TOPICS

While informal discussion was emphasized in preference to prepared presentations, the remarks were initiated in response to major points raised in the draft reports that were exchanged. The following major topics were addressed by the participants:

- The definition of compensation agreement and its distinction from barter and counterpurchase arrangements
- The balance of advantages and disadvantages from the US and Soviet perspectives of the development of economic relations on a compensatory basis
- The prospects for further development of compensation agreements in primary and manufactured product areas
- The necessity and availability of long-term credits for the development of compensation agreements
- Political considerations for compensatory trade, including the issue of economic dependence
- Problems of quality control and pricing
- The role of compensation agreements in the transfer of technology.

A summary of the points made by the US and Soviet scholars in each of these areas is presented below.

III ISSUES RAISED IN THE DISCUSSION

The Soviet scholars identified the characteristics which they felt distinguished compensation agreements. These characteristics included the large scale and long-term nature of the agreement and the repayment for deliveries of equipment, within a specified period of time, by compensatory deliveries of goods produced by the capacity created. The key factor distinguishing compensation agreements from barter and counter-purchase arrangements was deemed by the Soviet scholars to be the joint cooperation required in developing the productive capacity within the scope of facilitating intergovernmental agreements. US participants, on the other hand, observed that compensation agreements differed in the requirement for the Western firm to accept deliveries of Soviet goods which it must utilize or market at a specified future date. The necessity of the provision of long-term Western credits in connection with a compensation agreement was a point of debate. While stating that cooperation was the key factor, the Soviet participants argued that given the scale and time horizon, long-term credits were a necessary component of the arrangement. US members pointed out that in their view, long-term Western credits were not an essential feature and that the deals could be financed by the Soviet side.

Both sides acknowledged that prospects for further development of compensation agreements would be more readily accomplished in the extractive industries due to the greater confidence in the quality of raw material deliveries and the requirements in the West for a variety of industrial raw materials which might be met from Soviet resources. A US participant noted that the size of the required credits for such projects might present an obstacle, because large capital inputs normally are accompanied by equity participation. Even the removal of current restrictions of US government credit would not insure the availability on such a large scale.

Prospects for development of compensation agreements in manufacturing fields, it was acknowledged by both sides, do revolve on somewhat different criteria. The demand in the West for Soviet exports of manufactures is somewhat less established than for raw materials and US participants pointed to the more critical role of quality control in these areas. Soviet participants indicated that increased emphasis on quality is ongoing in all areas of the Soviet economy and observed that compensation arrangements might involve a continuing update of technology to be provided by the Western partner. The observation was also made that these updates would require additional payments to the Western firm. Several of the Soviet scholars noted that specific manufacturing capacity was specifically oriented to meet the requirement for export. Lack of MFN treatment was cited by Soviet participants as an obstacle to development of US export markets for Soviet manufactures.

In response to a question on prospects for compensation agreements in the energy field, Soviet scholars acknowledged that the USSR faces growing costs in developing new resources, but that the Soviet Union will remain a net exporter of oil. There will be a need for the USSR to conserve oil and explore alternative energy sources and reexamine commercial relations with respect to oil, but recent Western estimates depicting a bleak oil outlook were felt to be in error.

The discussion draft that had been prepared by SRI International presented a tabulation of advantages and disadvantages of developing trade via compensation agreements from the points of view of the Western partner and the Eastern (planned economy) partner. The Soviet participants felt that the numbers of advantages and disadvantages had been artificially balanced. It was agreed that it was the relative importance of particular points that was of concern in determining the net impact. The Soviet participants felt that the long-term mutual benefits of cooperation were paramount. US participants made the point in this discussion that the perspective of Western firms does imply that there are limitations in compensation arrangements which may offset benefits to the firm, particularly in regard to the profitability of future deliveries.

Political considerations with respect to trade on a compensation basis were also addressed in the discussion. In regard to US trade restrictions for national security reasons, a Soviet scholar observed that the alternative to the development of relations is the deterioration of relations. The response from a US participant was that both nations had agreed that their national security interests were a legitimate concern in developing relations and that export controls for national security reasons would not be subject to negotiation. Soviet scholars added that expressed US concerns about dependence on Soviet exports were unrealistic given the small share of US-USSR trade relative to the size of the two economies in the foreseeable future.

On the question of the availability of Western credit to finance compensation arrangements with the USSR, it was noted by Soviet participants that their long-term economic plans include export programs and the use of long-term credits, particularly as related to the further development of science and technology. The USSR, they added, is a good credit risk, has never defaulted, and that expanded capacity provided by deliveries of equipment on a compensation basis expands the ability of the Soviet Union to export to repay credits. The US projection of outstanding Soviet debt to 1980 was deemed too high in the Soviet view, because it was an extrapolation of data from the first half of the seventies, while the rate of indebtedness has been cut sharply in recent years. US observers noted that the correct picture of debt to the West should perhaps include Eastern Europe, since the USSR would, in fact, be the ultimate guarantor. The size of this total debt, it was added, does give lenders some concern and may at some point limit willingness to extend further credit, and even relaxation of restrictions on government participation in the extension of credit would not make available the volume of credit implied by the major compensation arrangements that have been proposed.

Two primary concerns in the operation of compensation agreements--quality control and pricing arrangements--were specifically addressed

in the discussion. US participants noted that the Western partner is seen to be accepting risk in the form of the competitiveness of the goods that are received as payback deliveries. If the quality of these goods were below his expectations, gains from lower production cost would be offset. Western experience indicates, it was observed, that even on-site quality control inspection might not be enough to minimize the risks and that the Western partner would seek some form of participation in management. Serious technology transfer, it has been found by Western managers, involves the virtual reorganization of the firm. Soviet participants stated that the USSR has experienced some success in establishing effective quality control, that the need for quality indicators and not just output targets was recognized and that mechanisms encouraging initiative from below along these lines were under consideration. While both sides acknowledged that compensation arrangements do provide some stability in trade relations, Western participants felt that they could not serve as guarantees against losses due to price fluctuations. An additional point was that if the profitability of payback deliveries was uncertain, this would be taken into account by the Western partner in pricing the deliveries of equipment of the USSR. In light of these complexities it was suggested that some form of production sharing might be more attractive to the Western firm than the straightforward compensation agreement.

The Soviet scholars acknowledged the need to establish more effective mechanisms in regard to quality control, technology transfer, and pricing arrangements, but felt that given the mutual benefits of long-term cooperation, the partners would be able to arrive at satisfactory resolution of these issues. Existing compensation arrangements were suggested as a model for what might be accomplished.

Appendix A
U.S./SOVIET WORKSHOP PARTICIPANTS

Appendix A

U.S. Workshop Participants

Edward S. Bozek	Bureau of East-West Trade, Department of Commerce
M. Mark Earle, Jr.	SRI International
Richard B. Foster	SRI International
Gary Fromm	SRI International
Weldon B. Gibson	SRI International
Edward A. Hewett	University of Texas
Allen Lenz	Bureau of East-West Trade, Department of Commerce
Paul Marer	Indiana University
Francis W. Rushing	SRI International

Observers from the U.S. Government and the US-USSR Trade and Economic
Council also attended workshop sessions

Soviet Workshop Participants

1. Primakov E.M.	IMEMO
2. Maximova M.M.	IMEMO
3. Anikin A.V.	IMEMO
4. Tsukanov S.V.	Ministry for Foreign Trade
5. Dvoretz N.L.	Gosplan
6. Bobrakov Y.I.	Institute of the U.S. and Canadian Studies
7. Naborov V.B.	NIKI of Ministry for Foreign Trade
8. Ivanov I.D.	Diplomatic Academy of Ministry for Foreign Affairs of the USSR
9. Belchuk A.I.	IMEMO
10. Pavlov V.G.	IMEMO
11. Rozenberg M.G.	Academy of Foreign Trade
12. Gorbunov S.V.	IMEMO
13. Ognev A.P.	IMEMO

Observers:

Gribkov M.N.	Soviet-American Trade Council
Popov B.L.	Soviet-American Trade Council
Zonova L.M.	IMEMO
Koroliev I.S.	IMEMO
Simonian R.R.	IMEMO